No. 92-1162

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1992

9221 ASSOCIATES and EDWARD E. SCHMITT, AGENT,

Petitioners,

v.

INDUSTRIAL STATE BANK,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did the Court of Appeals for the Eighth Circuit err in interpreting the scope of 11 U.S.C. § 541 by holding that an unauthorized lien placed on real estate of a limited partnership by the partnership's general partner did not constitute a transfer of the debtor partnership's interest in property where, in two prior unrelated cases, the Court of Appeals for the Eighth Circuit held that such an unauthorized lien was a transfer of an interest in the debtor partnership's property.

2. Did the Court of Appeals for the Eighth Circuit err in interpreting 11 U.S.C. §§ 101(54), 544, and 548 by holding that unauthorized lien placed on real estate of a limited partnership by the partnership's general partner did not constitute a transfer of the debtor partnership's interest in property where §§ 544 and 548 provide for the avoidance of a "transfer" defined in § 101(54) as "every mode . . . voluntary or involuntary, of disposing of or parting with property", and the clear terms of said statutes do not limit avoidable transfers to those that are authorized.

3. Did the Court of Appeals for the Eighth Circuit depart from the usual course of judicial proceeding by holding that an unauthorized lien placed on real estate of a limited partnership by the partnership's general partner did not constitute a transfer of the debtor partnership's interest in property, thereby allowing unauthorized lien documents to remain of record without resort to the means contemplated by Title 11, Chapter 5, United States

QUESTIONS PRESENTED – Continued

Code to avoid the same, and casting doubt upon any chain of title involving entities that must act through an agent.

4. Did the Court of Appeals for the Eighth Circuit err by holding that a defendant in a bankruptcy avoidance action may assert, as a defense, that another transaction, connected with the transaction sought to be avoided, is avoidable, and thereby create a conflict with the opinion of the Court of Appeals for the Seventh Circuit in *In the Matter of Xonics Photochemical,* 841 F.2d 198 (7th Cir. 1988).

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9221 ASSOCIATES and EDWARD E. SCHMITT, AGENT,

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v.

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On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

PETITION FOR WRIT OF CERTIORARI

The petitioners, 9221 Associates and Edward E. Schmitt, Agent, respectfully pray that writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit entered on August 26, 1992 in the above-captioned proceeding.

OPINIONS BELOW

The opinion of the United States Bankruptcy Court for the Western District of Missouri is not reported. It is reprinted in the Appendix, A-13 - A-42. The opinion of the United States District Court for the Western District

of Missouri on initial appeal is also unreported. It is reprinted in the Appendix, A-5 - A-12. The opinion of the United States Court of Appeals for the Eighth Circuit (App., A-1 - A-4) is reported at 973 F.2d 671.

JURISDICTION

The United States Bankruptcy Court for the Western District of Missouri entered judgment in favor of petitioners in the amount of $2,754,449.49, together with interest and costs, on July 13, 1990. Respondents' motion for reconsideration and to alter or amend the judgment was denied by order dated August 8, 1990. On October 7, 1991, the United States District Court reversed the bankruptcy court. On August 26, 1992, the United States Court of Appeals for the Eighth Circuit affirmed the district court. Petitioners' timely petition for rehearing was denied on October 5, 1992. Within 90 days thereafter, this Petition was filed with this Court. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 541(a) provides, in pertinent part:

The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

11 U.S.C. § 101(54)[1] provides:

"transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption.

11 U.S.C. § 544(a) provides, in pertinent part:

The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by –

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at

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[1] Because the renumbering and conforming amendments in 104 Stat. 4789 (1990) (Public Law 101-647, Title XXV, Subtitle B, § 2522(e)) did not take into account the renumbering created by 104 Stat. 267 (1990) (Public Law 101-311, Title I, § 101, Title II, § 201), there are 2 subsections numbered 54. The numbering used herein is the numbering resulting from the changes made by 104 Stat. 267.

such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists.

11 U.S.C. § 548(a) provides:

The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily –

(1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or

(iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

STATEMENT OF THE CASE

A. Underlying Facts

On April 9, 1985, Kroh Brothers Development Company ("KBDC"), purporting to act as general partner of 9221 Associates ("9221"), the debtor herein and a Missouri limited partnership, executed a promissory note in favor of Industrial State Bank ("ISB") in the original principal amount of $2,500,000.00 ("ISB loan"). To secure the promissory note, KBDC, purporting to act as general partner of 9221, executed a second deed of trust in favor of ISB on 9221's sole real estate asset ("9221 Building").

It is undisputed that KBDC had no authority to obtain the ISB loan or encumber the 9221 Building in such a fashion. It is further undisputed that (1) KBDC appropriated the ISB loan proceeds for its own purposes, and 9221 received none of the same, (2) 9221 could not, and ISB knew 9221 could not, repay the loan, and (3) ISB and its title insurer did not obtain the consents of the limited partners of 9221 to the ISB loan. On April 9, 1986, ISB renewed the loan.

On September 10, 1986, KBDC sent a loan request to Commerce Bank of Kansas City ("Commerce Bank"), requesting a loan of $5,000,000.00 to be secured by a second deed of trust on the 9221 Building. Consistent therewith, KBDC, purporting to act as 9221's general partner, executed a promissory note in the principal amount of $5,000,000.00 in favor of Commerce Bank ("Commerce Bank loan"). A condition of the Commerce Bank loan was that the ISB loan be paid so that Commerce Bank could obtain the second deed of trust position on the 9221 Building held by ISB. Accordingly,

KBDC, again purportedly as 9221's general partner, executed a second deed of trust in favor of Commerce Bank and the ISB loan was paid off with the Commerce Bank loan proceeds.

It is equally undisputed that KBDC, as 9221's general partner, did not have the authority to enter into the Commerce Bank loan or encumber the 9221 Building to secure that loan. Moreover, the remainder of the Commerce Bank loan proceeds not paid to ISB were used by, and for the benefit of, KBDC and not 9221.

B. Proceedings in the Courts Below

On February 13, 1987, Petitioner 9221 filed its petition for relief under Title 11, Chapter 11, United States Code in the United States Bankruptcy Court for the Western District of Missouri. KBDC filed its chapter 11 petition on the same day in the same court. At all times, 9221 acted as a debtor in possession under the authority of 11 U.S.C. § 1107.

During the period in which 9221 and KBDC sought reorganization, 9221 reviewed and investigated the propriety of the loans and transfers with Commerce Bank and ISB detailed in the foregoing section A. All claims between 9221 and Commerce Bank were resolved in the terms of 9221's second amended plan of reorganization, which was confirmed by the United States Bankruptcy Court for the Western District of Missouri on January 3, 1989. In the confirmed plan, Petitioner Edward E. Schmitt was appointed the agent to investigate and prosecute all causes of action of 9221 against ISB.

On February 10, 1989, petitioners brought their complaint against ISB. Jurisdiction in the United States Bankruptcy Court for the Western District of Missouri was conferred under 28 U.S.C. §§ 157(a), 157(b)(2)(b), 157(b)(2)(E), and 1334(b). The case was tried on petitioners' first amended complaint, and sought relief against ISB upon its receipt of a second deed of trust interest in the ISB loan transaction under 11 U.S.C. § 542, and state law claims for fraudulent conveyances (§ 428.020, R.S.Mo.) and monies had and received pursuant to 11 U.S.C. § 544. Relief was sought against ISB upon its receipt of the Commerce Bank loan proceeds as fraudulent conveyances pursuant to 11 U.S.C. §§ 548(a)(1), 548(a)(2)(B)(i), 548(a)(2)(B)(ii), and 548 (a)(2)(B)(iii).

Judgment was entered in favor of petitioners on all of the foregoing theories of relief, with the bankruptcy court, in its extensive findings of fact and conclusions of law, holding that both the transfer of the second deed of trust interest and the Commerce Bank loan funds to ISB were transfers of property of 9221. A-28. The bankruptcy court further held that ISB's defense that the Commerce Bank loan was unenforceable and, absent settlement, avoidable was an attempt to avoid a transaction by a party that was not granted avoidance powers, and, therefore, raised without standing. A-28 - A-29.

On appeal, the United States District Court for the Western District of Missouri reversed. Although accepting the bankruptcy court's conclusion that both the ISB and Commerce Bank loans were unauthorized, the district court held that since the unauthorized loans were not enforceable against 9221, neither the transfer of funds

or the recordation of liens which were part of the loans conveyed any of 9221's property. In addition, the district court reversed on the issue of ISB's standing to assert the avoidability of the Commerce Bank loan, holding that ISB was simply attempting to claim that the Commerce Bank loan proceeds were not property of 9221. A-9.

The United States Court of Appeals for the Eighth Circuit affirmed the opinion of the district court. On the property issue, the Court reasoned that the debtor had no property interest in the proceeds of the Commerce Bank loan because such loan was not enforceable against the debtor, and did not create a valid lien on the debtor's property. A-3. The court, in its brief opinion, did not address the standing issue.

REASONS FOR GRANTING THE PETITION

A. The Decision Below Creates an Intracircuit Conflict

The Eighth Circuit's decision affirmed the holding of the district court that the Commerce Bank loan proceeds paid to respondent, and the second deed of trust given to respondent, were not the property of 9221. Holding, as did all of the courts below, that both the ISB loan and the Commerce Bank loan were unauthorized, the Eighth Circuit reasoned:

> The debtor had no property interest in the proceeds of the Commerce Bank loan. The loan was not enforceable against the debtor, nor did it create a valid lien on the debtor's property. Commerce Bank, like Industrial State Bank, had no right to enforce the loan against 9221.

In re 9221 Associates, 973 F.2d 671, 672 (8th Cir. 1992). This analysis ignores the prior opinions of the Eighth Circuit and misconceives the nature of property of the bankruptcy estate.

11 U.S.C. § 541(a)(1) clearly states that property of the estate is comprised of, among other things, "all legal or equitable interest of the debtor in property as of the commencement of the case", no matter who holds that property. This Court has found the scope of this provision to be broad. *United States v. Whiting Pools*, 462 U.S. 198, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983).

In this proceeding, petitioners sought relief under 11 U.S.C. §§ 544 and 548. Both of these statutory provisions allow a debtor to avoid a transfer of property upon proof of certain specified elements. Both provisions require that the property sought to be recovered be property of the debtor, or property of the estate. The Eighth Circuit, in two prior cases, has recognized that a debtor's interest in property has been transferred under circumstances nearly identical to those presented in this proceeding.

In *In re Fox Hill Office Investors, Limited*, 101 B.R. 1007 (Bankr. W.D. Mo. 1989), *aff'd* Case No. 87-0096-1 (W.D. Mo. December 14, 1989), *aff'd* 926 F.2d 752 (8th Cir. 1991), the general partner of a limited partnership purported to obtain a loan for the partnership, which loan was secured by a junior mortgage on the partnership's real estate. The Bankruptcy Court held that the general partner was without authority to so act, *Fox Hill Office Investors*, 101 B.R. at 1014-1019, and that the partnership had not ratified the actions. *Fox Hill Office Investors*, 101 B.R. at 1019-1020. The

Eighth Circuit expressly affirmed these holdings. *Fox Hill Office Investors,* 926 F.2d at 753-755.

As a result of these findings, the bankruptcy court specifically found that the partnership was "not bound" by the mortgage, *Fox Hill Office Investors,* 101 B.R. at 1020, and that the mortgage was avoidable under 11 U.S.C. §§ 548 and 544:

> Mercantile recorded the mortgage on December 8, 1986, within one year of FHOI's bankruptcy filing on April 15, 1987. Accordingly, the Court concludes *that a transfer of property in which FHOI had an interest occurred* within one year of the filing of FHOI's petition in bankruptcy . . . For these reasons, the Court concludes that the elements of § 548(a)(2) have been met. Accordingly, the Court holds that the recordation of the mortgage is avoided pursuant to 11 U.S.C. § 548.
>
> Because the mortgage, after avoidance pursuant to § 548, was unrecorded on the date FHOI filed for bankruptcy, the Court further concludes that the mortgage was unperfected on that date as to FHOI, and holds that the mortgage should be avoided pursuant to 11 U.S.C. § 544.

Fox Hill Office Investors, 101 B.R. at 1021 (emphasis added). The Eighth Circuit affirmed the bankruptcy court's decision on the issue of whether the partnership's property had been transferred without comment or question. *Fox Hill Office Investors,* 926 F.2d at 753, 756.

There is no legally cognizable difference between this case and *Fox Hill Office Investors.* In both cases, loans to limited partnerships and liens against limited partnership

property were made and recorded without the authorization of the limited partnership. Both liens were of no effect, *Fox Hill Office Investors*, 101 B.R. at 1020; *9221 Associates*, 973 F.2d at 672. Both partnerships sought bankruptcy relief. Both partnerships sought to avoid the unauthorized loan transactions under § 544 and § 548 of the Bankruptcy Code. The only factual difference is that 9221 sought to recover the value of the lien, rather than to avoid the lien. 9221 was clearly entitled to seek such recovery under 11 U.S.C. § 550, which provides that "to the extent that transfer is avoided under section 544, 545, 546, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property. . . . " However, "[t]he Code specifically 'separates the identification of avoidable transfers (§ 547) from the identification of those who must pay (§ 550)' ". *In re H & S Transportation Company*, 939 F.2d 355, 358 (6th Cir. 1991), *quoting Levit v. Ingersoll Rand Financial Corp.*, 874 F.2d 1186, 1196 (7th Cir. 1989). Whether the elements of §§ 544 and 548 are proven does not turn on the remedy selected under § 550. Thus, under these indistinguishable facts, the Eighth Circuit has issued conflicting opinions as to whether the unauthorized liens at issue are property of the estate, and, in the case at bar, fails to address the conflict or even identify whose property was transferred if it was not the debtor's.

The Eighth Circuit has compounded the error and resulting confusion as the state of the law in the circuit by ignoring another virtually identical holding in *In re West Tech. Ltd.*, 104 B.R. 176 (Bankr. W.D. Mo. 1988), *aff'd*, 104 B.R. 181 (W.D. Mo. 1988), *aff'd*, 882 F.2d 323 (8th Cir.

1989). In that case, a general partner of a limited partnership obtained a loan, purportedly for the partnership, secured by an unrecorded mortgage on the partnership's real estate. The trial court and the courts on appeal all found that the general partner had no authority, under any agency theory, to execute the note and mortgage. The Bankruptcy Court, upon the stipulation of the parties, avoided the mortgage pursuant to 11 U.S.C. § 544. *West Tech*, 104 B.R. at 178. Such an avoidance could not have been accomplished under the clear terms of § 544 had no property of the debtor been transferred as a result of the unauthorized, unenforceable note and mortgage. This avoidance was not disturbed on appeal.

Under such identical fact patterns, the only apparent difference among these opinions is that petitioners sought to recover the value of the lien transferred to respondent, as opposed to avoiding the lien itself. Yet this difference does not bear on the question of whether the lien transferred property of 9221 or its bankruptcy estate. Here 9221 Associates relied, in part, on the prior holdings of the Eighth Circuit in formulating its reorganization, only to have the Eighth Circuit ignore these cases and, without explanation, impose a new and novel interpretation of § 541. Such holding by the Court of Appeals compels review of this federal statute by this Court. On a more practical level, the decision below, by not distinguishing or overruling the prior decisions at issue, leave the bench and bar in this circuit unable to determine the law. Such uncertainty must be resolved by this Court.

B. The Decision Below Limits and Misinterprets 11 U.S.C. § 101(54), 544, and 548

The Eighth Circuit's decision impairs the ability of any entity which must act through an agent to avail itself of the avoidance provisions of the Bankruptcy Code. Without even discussion of the issue, the decision effectively steps beyond the clear terms of the avoidance statutes.

11 U.S.C. § 101(54) makes clear that, for the purposes of Title 11, a "transfer" includes *every* form, whether "direct", "conditional", "voluntary", or "involuntary", of disposing of property, "including retention of title as a security interest". Sections 544 and 548 of the Bankruptcy Code require only a "transfer of property of the debtor" (§ 544) or a "transfer of an interest of the debtor in property" (§ 548). Nowhere in these three federal statutes is it required that the transfer of property be "authorized".

Under the prior decisions of the Eighth Circuit, *Fox Hill Office Investors and West Tech*, 9221 Associates had a property interest transferred when the second deed of trust was placed on its property and when respondent was paid for that deed of trust interest. As a result of the opinion at issue, 9221 Associates does not have such a property interest solely because the loans and liens were unauthorized. Leaving aside the error of this position, discussed for review *infra*, the effect of the decision precludes the use of bankruptcy avoidance provisions to entities which must act through agents.

Corporations and partnerships can only act through agents. It is beyond cavil that innumerable corporations

and partnership file for relief under the provisions of Chapter 11 of the Bankruptcy Code. It is not difficult to imagine that several of these types of debtors seek, while in bankruptcy, to rehabilitate their business affairs by avoiding loans and related liens that were incurred and created while the business was in financial difficulty by agents acting on their own in order to "save" the business. *Fox Hill Office Investors and West Tech* are examples. However, under the Eighth Circuit's opinion herein, if the loan or lien was unauthorized, *and only because the transfer was unauthorized,* no transfer of estate or debtor property would be effected. If no transfer of property was made, the avoidance powers found in the Bankruptcy Code cannot be used.[2]

Such a conclusion is foreclosed by the clear terms of the Bankruptcy Code. Nothing in §§ 101(54), 544, or 548 require that a transfer be "authorized". To imply such a limitation is to rewrite an otherwise clear statute. Such implied limitations cannot be condoned. *Toibb v. Radloff,* 501 U.S. ___, ___, 111 S.Ct. 2197, 2199, 115 L.Ed.2d 145, 151 (1991). Moreover, 11 U.S.C. § 546 provides statutory limitations on all of the Bankruptcy Code avoidance powers. That a transfer must be authorized is not among these limitations. Where Congress has set forth express limitations and exceptions, it must be presumed that no other limitations and exceptions are to be implied. *Johnson v. Home State Bank,* 501 U.S. ___, ___, 111 S.Ct. 2150, 2156, 115 L.Ed.2d 66, 77 (1991); *United States v. Smith,* 499

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[2] The avoidance powers found in 11 U.S.C. §§ 547 would be similarly limited. 11 U.S.C. § 547(b) ("[T]he trustee may avoid any transfer of an interest of the debtor in property. . . . ").

U.S. ___, ___, 111 S.Ct 1180, 1185, 113 L.Ed.2d 134, 145, (1991).

In view of the Eighth Circuit's implied amendments of the federal bankruptcy statutes, this Court is requested to immediately exercise its discretion to review this proceeding. Review by this Court is necessary for the further practical reason that bankruptcy courts and non-individual debtors seeking reorganization will be severely impeded in their attempts to formulate reorganization plans in cases where unauthorized liens on property are involved, thereby denying those debtors access to remedies that are available to individual debtors.[3]

C. The Decision Below So Far Departs From the Usual Course of Judicial Proceedings by Casting Doubt on Record Titles

Both the district court and the court below found that the second deed of trust interest of ISB in the 9221 Building was of no effect. Accordingly, both courts found that no property interest of 9221 Associates was transferred. Aside from questioning the propriety of this decision and its crippling effect on corporate or partnership reorganizations, the effects of the decision will cause havoc with the certainty of record titles.

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[3] Petitioners realize that this disparate treatment may well implicate due process considerations. However, petitioners did not raise any constitutional considerations in the courts below, and believe they are precluded from arguing such considerations in this Petition.

Consider the following hypothetical example: Six months before corporation X files for Chapter 11 relief, X's president requests and obtains a loan from Bank Y. As a part of the loan, Y obtains a mortgage on X's manufacturing plant. X's president, however, lacked any authority from X to obtain the loan or grant the lien and used the loan proceeds for his personal benefit. After filing for Chapter 11 relief, X removes its president and discovers the mortgage to Y.

Under the terms of the decision at issue, the mortgage is of "no effect". However, even if X can establish the elements of an avoidance provision such as § 548, it cannot avoid the mortgage. Although X might attempt avoidance by filing a petition to determine the validity, extent, and priority of a lien, the statute which authorizes such a petition, 11 U.S.C. § 506(d), states that "[t]o the extent that a lien *secures a claim against the debtor that is not an allowed secured claim*, such lien is void. . . . " (emphasis added). Under the reasoning of the decision at issue, the lien does not secure a claim against the debtor.[4] Such an attempt at avoidance would also fail.

The result is that X cannot avoid the recorded mortgage. But while the mortgage is of no effect, it remains

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[4] Although some language in this Court's opinion in *Dewsnup v. Timm*, 502 U.S. ___, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992) regarding a chapter 7 debtor's inability, under § 506(d), to "strip down" the liens of secured creditors with claims that are not fully secured might indicate that § 506(d) should be interpreted differently, the holding in *Dewsnup* is limited to its facts. "We therefore focus on the case before us and allow other facts to await their legal resolution on another day." *Dewsnup*, 502 U.S. at ___, 112 S.Ct. at 778, 116 L.Ed.2d at 911.

recorded. Under the decision of the Eighth Circuit herein, no action can be taken in the bankruptcy court to obtain any judicial determination that avoids the effect of such recordation. X is left with a recorded lien against its property, and no remedy. Congress, as noted in B., *infra*, did not intend such a result. If the Eighth Circuit's decision is left standing, such results will become common in this circuit. In turn, debtors seeking reorganization will be impaired in their efforts to obtain loans secured by property, title to which is clouded by such an unauthorized lien. Similarly, corporations and partnerships not in bankruptcy will be faced with the same inability to readily obtain needed financing because such collateral will not be acceptable to lending institutions or title companies. Petitioners request that this Court exercise its supervisory powers to review and overturn the Eighth Circuit's opinion and prevent the above-described clouding of record titles.

D. The Decision Below Creates an Intercircuit Conflict

At trial, petitioners argued, and the bankruptcy court found, that respondent's contention that the unenforceability and avoidability of the Commerce Bank loan under *Fox Hill Office Investors* rendered the Commerce Bank loan proceeds property of someone other than petitioners, was an effort to avoid the Commerce Bank loan and usurp the avoidance powers reserved under the Bankruptcy Code to trustees and debtors in possession. The district court rejected petitioners' argument, holding:

> in the case at bar ISB is not seeking to usurp the trustee's avoidance powers with regard to the Commerce Bank loan but rather is seeking to

> defend its own interests from the invocation of such avoidance power by 9221 with regard to the ISB loan. Certainly ISB has standing to assert that 9221 had no property interest in the loan proceeds sought to be divested from ISB.

A-9. The Eighth Circuit opinion does not expressly address this issue. However, the court's holding is *pro tanto* an affirmance of the district court. Such holding is in conflict with the opinion of the United States Court of Appeals for the Seventh Circuit in *In the Matter of Xonics Photochemical*, 841 F.2d 198 (7th Cir. 1988).

In *Xonics*, debtor sought to recover, as preferential under 11 U.S.C. § 547, two payments for goods shipped to debtor by defendant. Defendant sought to defend the claim by asserting that debtor was not insolvent at the time of the transfers, a required element of proof in a preference case. Defendant's argument was premised on the ground that certain of debtor's liabilities, specifically, a guaranty of a subsidiary's line of credit and the co-making of another obligation, were avoidable under either 11 U.S.C. §§ 544 or 548 and, therefore, not chargeable as a liability of the debtor. The Seventh Circuit specifically rejected the argument, noting "[t]he right to invoke these provisions belongs not to a particular unsecured creditor such as Mitsui but to the trustee (or debtor in possession) as the representative of all the unsecured creditors . . . . " *Xonics* at 202.

Such holding has direct application in this case. Respondent seeks to declare the Commerce Bank loan unenforceable and avoidable, thereby rendering transfer of the loan proceeds (in its view) property of an entity other than 9221 Associates, in order to rebut, as in *Xonics*,

an element of petitioner's case-in-chief. To declare the Commerce Bank loan avoidable requires the use of avoidance powers reserved, as in *Xonics*, to the debtor in possession. Since the Eighth Circuit's opinion in this case conflicts with the holding of the Seventh Circuit in *Xonics*[5], this Court should exercise its discretion to ensure the uniformity of decisions respecting the "uniform Laws on the subject of Bankruptcies". U.S. Const. art. I, § 8.

CONCLUSION

The Eighth Circuit's opinion flagrantly conflicts with and ignores its own prior opinions with respect to whether 9221 Associates has an interest in the property sought to be recovered under § 541. The resultant uncertainty to parties in the circuit compels review. Moreover, the implied amendment of three federal statutes and effective impairment of the ability to remove clouds on recorded titles, which result from the Eighth Circuit's rationale, must be corrected. Finally, the conflict with the Seventh Circuit on the issue of whether respondent may

[5] The opinion at issue also conflicts with a prior Eighth Circuit opinion holding that only a trustee may assert that a lien was unperfected, and therefore avoidable under § 544. *See Saline State Bank v. Mahloch*, 834 F.2d 690 (8th Cir. 1987)

assert its primary defense is yet additional cause under the rules of this Court to review this case. The petition for a writ of certiorari should be granted.

Respectfully submitted,

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Attorneys for Petitioners

In re 9221 ASSOCIATES, Debtor.

9221 ASSOCIATES and Edward E. Schmitt, Appellants,

v.

INDUSTRIAL STATE BANK, Appellee.

No. 91-3571.

United States Court of Appeals,
Eighth Circuit.

Submitted June 8, 1992.

Decided Aug. 26, 1992.

Rehearing and Rehearing En Banc
Denied Oct. 5, 1992.

Truman K. Eldridge, Jr., Kansas City, Mo., argued (Truman K. Eldridge, Jr., Jennifer D. Putman and Jerald S. Meyer, on the brief), for appellants.

R. Dickey Hamilton, Chicago, Ill., argued (R. Dickey Hamilton, Byron J. Beck and A. Bradley Bodamer, on the brief), for appellee.

Before RICHARD S. ARNOLD, Chief Judge, HENLEY, Senior Circuit Judge, and MAGILL, Circuit Judge.

RICHARD S. ARNOLD, Chief Judge.

This is an adversary proceeding in bankruptcy in which the debtor, 9221 Associates, a limited partnership, seeks to recover from Industrial State Bank $2,500,000. The Bankruptcy Court held for the debtor, but the District

Court[1] reversed. We affirm the judgment of the District Court.

We have little to add to the District Court's opinion. It is commendably brief and penetrating in its legal analysis.

In 1985, Kroh Brothers Development Company (KBDC), the general partner of 9221, asked Industrial State Bank to lend 9221 $2,500,000, to be secured by a second deed of trust on 9221's sole asset, an office building located at 9221 Ward Parkway in Kansas City, Missouri. KBDC had no authority to make this request, and the loan proceeds were not applied to the benefit of 9221. Instead, KBDC appropriated them for itself. The Bankruptcy Court held, and we agree, that the note and deed of trust given to Industrial State Bank on this occasion were not valid. They were unauthorized and not enforceable against 9221.

Later, in 1986, KBDC made a second, similarly unauthorized loan request to another bank, Commerce Bank. This request was approved by Commerce Bank. Part of the loan proceeds went to Industrial State Bank to pay off the existing second deed of trust. This loan was just as invalid as the first one. Both of them were unauthorized, invalid, and unenforceable against 9221.

In the present case, 9221 seeks to recover from Industrial State Bank the $2,500,000 that it received from Commerce Bank. This money, 9221 argues, is property of the debtors' estate.

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[1] The Hon. Dean Whipple, United States District Judge for the Western District of Missouri.

For the reasons ably given in the opinion of the District Court, we reject this argument. The debtor had no property interest in the proceeds of the Commerce Bank loan. The loan was not enforceable against the debtor, nor did it create a valid lien on the debtor's property. Commerce Bank, like Industrial State Bank, had no right to enforce the loan against 9221. "Thus, 9221 was not bound *either* by the ISB note and second deed of trust *or* the Commerce promissory notes and second deed of trust executed by KBDC." *In re 9221 Associates,* No. 91-0196-CV-W-1, slip op. 6 (W.D. Mo. Oct. 7, 1991).

We adopt as our own the following passage from the opinion of the District Court:

> Inasmuch as the ISB note was not binding on 9221 and did not create a valid debt of 9221 nor encumber the property of 9221, it affected no property interest of 9221. The bankruptcy court found that the ISB note and deed of trust "were not enforceable obligations or valid, antecedent debts of 9221." (F & C at 8) What is true of the ISB note is true of the Commerce note. They were created under exactly the same circumstances. At best, the ISB and Commerce loans were unsecured obligations of KBDC. The fact that payment of the ISB note was accomplished by KBDC obtaining a loan secured by an invalid mortgage does not change the fact that no property interest of 9221 was affected by the Commerce loan. KBDC accomplished the payment of its obligation to its creditor ISB through the guise of appearing to be giving something of value to Commerce. The representations of KBDC that the second deed of trust was valid, and Commerce's faith in that validity, do not

> invest the second deed of trust with validity. Accordingly, the property of 9221 purportedly mortgaged by that deed of trust was unaffected in any manner. Inasmuch as 9221 can assert no property interest in the proceeds of the Commerce loan, it cannot prevail under the Bankruptcy Code on its claim to avoid the payment of the proceeds to ISB.

Id. at 7.

The judgment of the District Court, which reversed the judgment of the Bankruptcy Court in debtor's favor, is affirmed.

IN THE UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF MISSOURI
WESTERN DIVISION

IN RE: 9221 ASSOCIATES, a Missouri limited partnership, Debtor,	
9221 ASSOCIATES, a Missouri limited partnership, and EDWARD E. SCHMITT, agent	
Plaintiffs-Appellees,	No. 91-0196-CV-W-1
v.	*Bankruptcy No. 87-00644-1-11*
INDUSTRIAL STATE BANK,	*Adversary No. 89-4044-1-11*
Defendant-Appellant	

ORDER

(Filed Oct. 7, 1991)

This matter is before the Court on appeal from the bankruptcy court. The debtor, plaintiff-appellee, 9221 Associates ("9221") brought an adversary proceeding seeking to avoid the payment of $2.5 million of loan proceeds by its general partner, Kroh Brothers Development Company ("KBDC") to the defendant-appellant, Industrial State Bank ("ISB"). On July 13, 1990, the bankruptcy court[1] entered judgment in favor of 9221 and against ISB and this appeal followed. For the reasons set out below, the bankruptcy court's order is reversed.

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[1] The Honorable Karen M. See, United States Bankruptcy Court, Western District of Missouri.

FACTUAL BACKGROUND

9221 is a partnership comprised of one general partner, KBDC, and several limited partners. 9221's sole asset and source of income is an office building located at 9221 Ward Parkway, Kansas City, Missouri. In April, 1985, the 9221 office building was subject to a first deed of trust in the amount of $4,265,160.

On March 26, 1985, KBDC, purporting to act on behalf of the partnership, submitted a loan request to ISB for $2,500,000 to be secured by a second deed of trust on the 9221 office building. The 9221 Partnership Agreement required the consent of the limited partners prior to allowing aggregate borrowing to exceed $4,500,000. KBDC did not obtain, nor did ISB request proof of, the consent of the limited partners regarding the $2,500,000 loan to 9221. The limited partners were unaware of KBDC's actions and did not at any time authorize the actions.

Nevertheless, ISB approved the loan and disbursed the loan proceeds by way of a check made payable to "9221 Associates, a Missouri limited partnership by Kroh Brothers Development Company, General Partner." KBDC endorsed the check, "9221 Assoc. For Deposit Only Pay Commerce 2825487" and deposited the proceeds in a Commerce Bank account utilized by KBDC. This bank account was not an account available to or used by 9221.

KBDC subsequently further diverted the $2,500,000 loan proceeds by transferring the funds from Commerce Bank by way of two checks, one in the amount of $900,000 and another in the amount of $160,000. These

checks then were deposited in two separate KBDC corporate accounts at United Missouri Bank. KBDC used the loan proceeds for its own purposes and not to further any partnership interest of 9221.

In September, 1986, KBDC, again purporting to act on behalf of the partnership, submitted yet another loan request to a second bank, Commerce Bank, for a $5,000,000 loan also to be secured by a second deed of trust on the 9221 property. By agreement of KBDC, part of these loan proceeds were to be used to pay off the ISB loan and remove the existing second deed of trust on the 9221 property held by ISB. Commerce Bank approved the loan request.

Thereafter, on October 9, 1986, at the direction of KBDC, Commerce Bank delivered a check in the amount of $2,517,465.75 to Chicago Title to be wire-transferred to ISB's account at Security National Bank of Kansas City in full payment of the ISB loan. The balance of the funds were deposited in KBDC's account at Commerce Bank. Commerce Bank received a $5,000,000 promissory note and second deed of trust on the 9221 property executed by KBDC. Once again, the 9221 limited partners had no knowledge of the loan request and did not authorize it or consent to it. Once again, KBDC used the loan proceeds for its own purposes and not to further any interest of 9221. Once again, the loan was made in contravention of the express provisions of the 9221 partnership agreement.

On February 13, 1987, 9221 filed its Chapter 11 petition. Its general partner, KBDC, also filed a Chapter 11 petition the same day. Subsequently, 9221's agent, Edward E. Schmitt brought this adversary proceeding

seeking to avoid the $2.5 million payment to ISB by Commerce Bank made at the direction of KBDC. After trial of this case, the bankruptcy court entered judgment in favor of plaintiffs 9221 Associates and Edward E. Schmitt, Agent in the amount of $2,517,465.75, plus pre-judgment interest and costs. This appeal followed.

DISCUSSION

The bankruptcy court's findings of fact may not be set aside unless clearly erroneous. Bankruptcy R. 8013. However, its conclusions of law are subject to *de novo* review by the district court. *Erickson v. Polk*, 921 F.2d 200, 201 (8th Cir. 1990). Likewise, issues on appeal involving mixed questions of law and fact are reviewed *de novo*. *United States v. Benson*, 88 B.R. 210 (W.D. Mo 1988).

The bankruptcy court found the proceeds of the Commerce loan that were used to pay the ISB loan to be the property of 9221 at the time of the October 9, 1986 transfer. The Court further held that the transaction was avoidable under the Bankruptcy Code inasmuch as (1) the transfer was made with intent to defraud creditors; (2) the debtor received no value for the transfer and was insolvent as a result of the transfer; and (3) at the time of the transfer the debtor was engaged in a business for which its remaining property was an unreasonably small capital.

On appeal, ISB contends the bankruptcy court erred in its finding that the Commerce loan proceeds were the property of 9221. In essence, ISB argues that by negotiating the promissory notes and second deeds of trust without the requisite authorization, consent or subsequent

ratification of the limited partners of 9221, KBDC was acting outside the proper scope of its authority as an agent of 9221. ISB further contends that an agent cannot affect property rights on behalf of a principal without the principal's authority to do so. Consequently, attempts at mortgaging 9221's property by KBDC were invalid and did not affect any property interest of 9221. Correspondingly, 9221 can assert no property right in the payment of the loan secured by the invalid mortgage. Accordingly, ISB argues that since 9221 can assert no property interest in the proceeds of the Commerce loan, it cannot avoid the payment of the proceeds to ISB.[2] This Court agrees.

In order for a transaction to be avoidable under the Bankruptcy Code a debtor must first show that it has a property interest in the property that is the subject of the transaction it seeks to avoid. *See* 11 U.S.C. §§ 542 and 548. Likewise, in order to set aside a transaction under the Missouri Fraudulent Conveyance Statute, the conveyance must involve the debtor's property. *Lindell v. Commonwealth,* 611 S.W.2d 283, 286 (Mo. Ct. App. 1980). In the case at bar, 9221 must show that it had a property interest in the proceeds of the Commerce bank loan before it can

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[2] 9221 asserts that ISB as a creditor has no standing to assert avoidance powers under the Bankruptcy Code. Avoidance powers are indeed reserved under the Code for the debtor in possession or the trustee. *Matter of Xonics Photochemical, Inc.,* 841 F.2d 198, 202 (7th Cir. 1988) However, in the case at bar ISB is not seeking to usurp the trustee's avoidance powers with regard to the Commerce bank loan but rather is seeking to defend its own interests from the invocation of such avoidance power by 9221 with regard to the ISB loan. Certainly ISB has standing to assert that 9221 had no property interest in the loan proceeds sought to be divested from ISB.

prevail on its claim that the loan proceeds be placed in the bankrupt estate of 9221.

9221 contends essentially that the loan proceeds were given in exchange for a fraudulent mortgage on its property so therefore 9221 had a property interest in the proceeds. Such is not the case. The bankruptcy court found that "KBDC lacked contractual, statutory and common law authority to enter into the ISB loan and Commerce loan, and both loans were unauthorized." (F & C at 9) It is indeed clear that KBDC was acting completely outside the scope of its authority as agent and general partner of 9221 when it attempted twice to mortgage the property of 9221 in contravention of the Partnership Agreement.

Where the limited partners have not ratified the transaction, a partnership is not bound by a promissory note or mortgage executed by a general partner acting beyond the scope of his authority. *In re Fox Hill Office Investors, Ltd.*, 101 B.R. 1007, 1020 (Bkrtcy. W.D.Mo), *aff'd*, No. 87-96-1-11 (W.D.Mo., Dec. 14, 1989), *aff'd*, No. 90-1074 W M (8th Cir., Feb. 25, 1991). The limited partners of 9221 did not at any time ratify the actions of KBDC in executing the note or second deed of trust with ISB or Commerce. (F & C at 10-12, 19-22) Thus, 9221 was not bound *either* by the ISB note and second deed of trust *or* the Commerce promissory notes and second deed of trust executed by KBDC. "Clearly, specific partnership property cannot be assigned by a partner to secure personal debts. . . . An attempted assignment for such debts is void." *Bates County National Bank v. Wilson*, 767 S.W. 2d 101, 103 (Mo. App. 1989) (citations omitted.)

Inasmuch as the ISB note was not binding on 9221 and did not create a valid debt of 9221 nor encumber the property of 9221, it affected no property interest of 9221. The bankruptcy court found that the ISB note and deed of trust "were not enforceable obligations or valid, antecedent debts of 9221." (F & C at 8) What is true of the ISB note is true of the Commerce note. They were created under exactly the same circumstances. At best, the ISB and Commerce loans were unsecured obligations of KBDC. The fact that payment of the ISB note was accomplished by KBDC obtaining a loan secured by an invalid mortgage does not change the fact that no property interest of 9221 was affected by the Commerce loan. KBDC accomplished the payment of its obligation to its creditor ISB through the guise of appearing to be giving something of value to Commerce. The representations of KBDC that the second deed of trust was valid, and Commerce's faith in that validity, do not invest the second deed of trust with validity. Accordingly, the property of 9221 purportedly mortgaged by that deed of trust was unaffected in any manner. Inasmuch as 9221 can assert no property interest in the proceeds of the Commerce loan, it cannot prevail under the Bankruptcy Code on its claim to avoid the payment of the proceeds to ISB.

Accordingly, it is

ORDERED that the judgment entered by the bankruptcy court in favor of 9221 and against ISB is reversed. It is further

ORDERED that, in light of the foregoing reversal, the Motion of Defendant Industrial State Bank for Approval

of Security for Judgment and the Motion of 9221 Associates and Edward E. Schmitt, Agent, For Leave to Request the Bankruptcy Court to Enter Order Correcting Judgment are denied as moot.

/s/ Dean Whipple
DEAN WHIPPLE
UNITED STATES DISTRICT JUDGE

DATE: Oct. 7, 1991

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF MISSOURI

9221 ASSOCIATES, a Missouri Limited Partnership, Debtor.	)	Case No. 87-00644-1-11
9221 ASSOCIATES and EDWARD E. SCHMITT, Agent, Plaintiffs,	)	
vs.	)	Adv. No.
INDUSTRIAL STATE BANK, Defendant.	)	89-4044-1-11

FINDINGS OF FACT AND CONCLUSIONS OF LAW

(Filed July 13, 1990)

Trial of this adversary action was February 7-15, 1990. Plaintiff's First Amended Complaint seeks judgment on eight counts, including: turnover under § 542; fraudulent conveyance under §§ 548(a)(1), (b)(2)(B)(i), (b)(2)(B)(ii), and (b)(2)(B)(iii); fraudulent conveyance under state law, §§ 428.020, 428.040 RSMo.; and monies had and received. Defendant's defenses included an assertion that plaintiff's limited partners had ratified the disputed transactions.

The court, after reviewing extensive testimony and exhibits, Plaintiffs' and Defendant's Factual Stipulation, and arguments, makes the following findings of fact and conclusions of law and enters judgment in favor of plaintiffs and against defendant. The court has jurisdiction over this core proceeding under 28 U.S.C. § 157(b); venue is proper pursuant to 28 U.S.C. §§ 1334 and 1409.[1]

All citations to the transcript, stipulation and exhibits are set forth in end notes.

I. FINDINGS OF FACT

9221 Associates ("9221"), which is the debtor and plaintiff, filed its Chapter 11 petition on February 13, 1987. At all times 9221 has acted as debtor-in-possession pursuant to 11 U.S.C. § 1107 with all powers attendant thereto.[2] 9221's general partner, Kroh Brothers Development Company ("KBDC"), filed a Chapter 11 petition the same day and also has a confirmed plan. Pursuant to Article 12.3 of the Second Amended Plan of Reorganization (hereinafter "Plan"), confirmed by Order of this court dated January 3, 1989, plaintiff Edward E. Schmitt is the designated Agent to investigate and prosecute all causes of action 9221 may have against defendant Industrial State Bank ("ISB").[3] ISB is a Kansas banking corporation.[4]

9221 is a Missouri limited partnership formed January 4, 1977 by Agreement of Limited Partnership. The Agreement of Limited Partnership was amended August 29, 1978.[5] At all times prior to February 13, 1987 KBDC was the general partner of 9221.[6]

Prior to February 13, 1987, the limited partners of 9221 and their units of participation were: Alice (Lowenthal) Hechter, 7,407; Barbara Cleveland, 14,815; Howard Tierney, 16,667; Arthur Solomon, 14,815; Arthur Cowan, Jr. (and after his death the Estate of Arthur Cowan, Jr.), 12,963; Joseph Cohen, 11,112; Ann Swift Evans (subsequently The Ann Swift Evans Trust), 7,407; Joseph Gilbert, Jr., 7,407; and Aline Cassady, 7,407.[7]

Pursuant to the First Amended Agreement of Limited Partnership dated August 29, 1978 ("Partnership Agreement") the sole business of 9221 is, and has been, the ownership and operation of an office building, the 9221 Ward Parkway Building, in Kansas City, Missouri.[8]

On May 8, 1979, 9221 executed a Promissory Note for $4,400,000 to Mercantile Trust Company, secured by a First Deed of Trust on the 9221 Ward Parkway Building; the First Deed of Trust was subsequently assigned to New York Life Insurance Company.[9] As of April 1, 1985, the amount due under the First Deed of Trust was $4,265,160.[10]

On March 26, 1985, Jack Kroh, KBDC's President, submitted a loan request to ISB for a $2,500,000 loan to 9221, to be secured by a second deed of trust on the 9221 Ward Parkway Building.[11] General partner KBDC intended to use the proceeds of the ISB loan for KBDC's working capital.[12] In March and April of 1985 KBDC was experiencing a severe cash flow shortage and it was common for KBDC to use the equity of properties owned by limited partnerships with which it was affiliated for KBDC's own purposes.[13] 9221 had no specific need for funds at the time of the ISB loan.[14]

ISB understood that the purpose of the loan was for general partner KBDC to repurchase the then existing limited partnership interests and relied on KBDC to pay off the loan from the proceeds of the sale of new limited partnership interests to be completed within three to six months.[15] ISB made no inquiries as to the identity of the

intended purchasers of the new limited partnership interests or as to why such purchasers were not obtaining the loan(s).[16]

Prior to March 26, 1985, ISB had reviewed KBDC's Report on Examination dated December 31, 1984 which indicated that in 1984, 9221 had net cash flow after operating expense and debt service of $153,478.00.[17] ISB knew or had reason to know that the 9221 limited partnership could not from its own resources repay the ISB loan, that the ISB loan would render 9221 insolvent in that it would be unable to pay its debts as they become due,[18] and that the ISB loan would make it impossible to carry on the ordinary business of the partnership.[19]

ISB had a copy of the Partnership Agreement in its loan files prior to closing the loan.[20] The Partnership Agreement required that the limited partners had to consent if aggregated borrowings were to exceed $4,500,000. 9221's limited partners had no knowledge of the ISB loan prior to February 13, 1987 and did not consent to or authorize the loan.[21] ISB did not seek consents of the 9221 limited partners, obtain consents of the limited partners, or verify that such consents had been obtained.[22] KBDC also did not seek or obtain consents of the limited partners, or verify that such consents had been obtained.[23]

Prior to closing the loan, ISB received a Title Commitment from Chicago Title Insurance Company which excepted the loan from coverage if the consent of the limited partners was necessary.[24] Chicago Title had a copy of the Partnership Agreement at the time it issued the Loan Commitment and Loan Policy.[25] ISB did not obtain an opinion letter from counsel as to KBDC's

authority to execute the ISB Note and Deed of Trust. As a condition of closing the loan, ISB instructed Chicago Title to delete the exceptions requiring consent of the limited partners, so that the loan would be insured without such consents.[26]

ISB did not follow its policies, practices and procedures with respect to the ISB loan in that: (a) the amount of the loan exceeded 80% of the property's appraised value less the first mortgage; and (b) ISB did not have 9221 financial statements for the current or three prior years.[27]

On April 9, 1985 KBDC, purporting to act as 9221's general partner, executed a Real Estate Promissory Note for $2,500,000, payable to ISB, and executed a Deed of Trust, Security Agreement and Assignment of Leases and Rents, covering 9221 Ward Parkway Building to secure payment of the ISB Note.[28] The Deed of Trust securing the ISB Note was recorded by ISB on April 9, 1985 in Jackson County, Missouri.[29]

Due to the note secured by the first deed of trust with a balance of $4,265,160, as a result of the ISB loan, the aggregate outstanding indebtedness of 9221 exceeded the $4,500,000 borrowing limit contained in the Partnership Agreement, Paragraph 19.[30]

On April 10, 1985, ISB disbursed the loan proceeds by delivering its Check No. 23399 for $2,500,000 payable to "9221 Associates, a Missouri limited partnership by Kroh Brothers Development Company, General Partner" and delivering it to KBDC.[31] The same day, KBDC endorsed the check "9221 Assoc. For Deposit Only Pay Commerce

2825487" and deposited the check in KBDC's Account No. 282-548-7 at Commerce Bank.[32]

On April 10, general partner KBDC, by its check written on Account No. 282-548-7 at Commerce Bank, deposited $900,000 in KBDC's Account No. 109-082-8 at United Missouri Bank.[33] On April 11, KBDC, by its check written on Account No. 282-548-7 at Commerce Bank, deposited $1,600,000 in KBDC's Account No. 109-082-8 at United Missouri Bank.[34]

KBDC Account No. 282-548-7 at Commerce Bank was a KBDC corporate account generally used for building projects under construction and for tenant finish work. It was not used by 9221 or for its purposes.[35] KBDC Account No. 109-082-8 at United Missouri Bank was a corporate account, used by KBDC corporate entities and wholly owned subsidiaries or for their purposes; it was not used by 9221 or for its purposes.[36]

Prior to August, 1985, rents received by 9221 and other KBDC related limited partnerships were deposited either at a central disbursement and depository account at Commerce Bank in the name of Kroh Brothers Management Co., Account No. 241-659-5, or at a central depository and disbursement account at United Missouri Bank in the name of Kroh Brothers Management Co., Account No. 1136194, and all operating expense and debt service payments for 9221 and other KBDC related limited partnerships were made from these accounts.[37] After August, 1985 rents were deposited in the central disbursement and depository account at Commerce Bank and operating expense and debt service payments were made from this account.[38]

9221 was rendered insolvent by the ISB loan in that it was unable to pay its debts as they became due[39]; and 9221's liabilities exceeded its assets on April 9, 1985.[40]

General partner KBDC concealed the ISB loan as evidenced by the following:

(a) although KBDC prepared quarterly reports to the limited partners, the ISB loan was not disclosed on these reports[41];

(b) a 1985 Financial Statement for 9221 was never prepared;[42]

(c) the ISB loan was recorded on KBDC's general ledger books as a KBDC obligation,[43] and was not recorded on 9221's general ledger until an audit adjustment was made to the April, 1985 general ledger of 9221 in April, 1986;[44] and

(d) the interest expense on the ISB loan was recorded as an "intercompany payable of 9221's books and records.[45]

The funds disbursed by ISB pursuant to the ISB loan were not requested for, paid to or used for any purpose of 9221; rather, the funds were requested for, paid to and used by KBDC for its own purposes.[46]

Payment of debt service on the ISB loan for the last eight months of 1985 was $180,684.92.[47] On April 9, 1986, ISB and KBDC, purportedly as general partner of 9221, executed an Extension Agreement of the $2,500,000 ISB Note extending the maturity of the Note from April 9, 1986 until October 10, 1986.[48] The ISB loan was extended automatically and ISB took no steps to determine whether it was an authorized partnership transaction or whether the partnership could repay the loan.[49]

On September 10, 1986, KBDC President Jack Kroh sent a loan request to Commerce Bank requesting a $5,000,000 six-month loan to be secured by a second deed of trust on the 9221 Ward Parkway Building. The loan proceeds were to be used to pay the ISB Note and Deed of Trust and to fund the purchase of the limited partners' interests in 9221 by KBDC.[50]

On October 9, 1986, KBDC, purporting to act as general partner of 9221, executed a Real Estate Promissory Note for $5,000,000, payable to Commerce Bank, and executed a Deed of Trust covering the 9221 Ward Parkway Building to secure payment of the Commerce Note.[51]

KBDC, purporting to act as general partner of 9221, caused the ISB loan to be paid with the proceeds of the Commerce Note,[52] pursuant to which, on October 9, 1986, Commerce Bank delivered its cashier's check in the amount of $2,517,465.75 to Chicago Title to be wire-transferred to ISB's account at Security National Bank of Kansas City.[53] On October 10, 1986, Chicago Title wire-transferred $2,517,465.75 to Security National Bank of Kansas City for ISB's Account No. 8001529 to pay the ISB loan.[54]

Debtor was or became insolvent on October 9, 1986 as a result of the Commerce loan and ISB loan payoff in that debtor was unable to pay its debts as they became due and its liabilities exceeded its assets.[55]

The balance of the Commerce loan was deposited by Commerce Bank into KBDC's Account No. 282-548-7 at Commerce Bank.[56] The 9221 limited partners had no knowledge of the Commerce loan prior to February 13, 1987, and did not consent to or authorize it.[57]

The transfers described above, relating to the loan from ISB and payment of the ISB loan with proceeds from the Commerce loan, both of which loans were secured by 9221's sole asset, the office building, were made with actual intent to hinder, delay or defraud 9221's creditors.[58]

The transfers were made for less than a reasonably equivalent value given by ISB because:

(a) KBDC lacked authority to execute the ISB Note, Deed of Trust and Extension Agreement and therefore, the agreements were not enforceable obligations or valid, antecedent debts of 9221; thus, such transfers were not in exchange for, in satisfaction of, or securing a present or antecedent debt of 9221;

(b) 9221 received no consideration for the ISB loan because the proceeds were deposited in the KBDC's account and immediately used by KBDC for its own purposes; and

(c) 9221 received no consideration as a result of payment of the ISB loan on October 10, 1986 because ISB's second deed of trust interest was, in effect, transferred to Commerce, and Commerce continued to hold, as of October 10, 1986, a second deed of trust on the 9221 Ward Parkway Building.[59]

At the times of the transfers described above, 9221 was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with debtor was an unreasonably small capital;[60] debtor intended to incur, or believed that it would incur, debts that would be beyond its ability to

pay as such debts matured;[61] and the transfers made it impossible for 9221 to carry on the usual business of the partnership.[62]

Pursuant to the Plan, 9221 is granted all the powers and duties of a trustee under the Bankruptcy Code and succeeds to all of the rights of a lien creditor, judgment creditor, or unsecured creditor and may avoid any transfers undertaken or made by debtor, which could have been set aside by a lien creditor, judgment creditor, or unsecured creditor, pursuant to 11 U.S.C. §§ 544(a) and (b).

9221 is indebted to the Segregated Fund, established in the Second Amended Joint Plan of reorganization confirmed in KBDC's Chapter 11 proceeding, for advances made to the partnership for professional services rendered to the partnership during 9221's reorganization proceeding.[63]

KBDC lacked contractual, statutory and common law authority to enter into the ISB loan and Commerce loan, and both loans were unauthorized, in that:

(a) the Partnership Agreement required consent of the limited partners for all borrowings in excess of $4,500,000 and that consent was not obtained;[64]

(b) the stated purposes of the loans were not for any partnership purpose in that they were to be used by KBDC to buy the limited partners' interests;[65]

(c) the actual purpose of the ISB loan was not for a partnership purpose in that it was used to fund KBDC's cash flow;[66]

(d) the loans rendered it impossible to carry on the ordinary business of the partnership;[67]

(e) ISB knew or should have known the Partnership Agreement required the limited partners' consent;[68] and

(f) ISB knew or should have known the ISB loan was for KBDC's purposes and not for the purpose of the partnership.[69]

The funds from the Commerce loan used to pay the ISB loan on October 10, 1986 were property of debtor at the time of the payment, and at all times thereafter. Plaintiffs demanded return of the funds had and received by ISB on October 10, 1986, but defendant failed and refused to return the same to plaintiffs.[70] Plaintiffs are entitled to prejudgment interest from February 10, 1989 through March 28, 1990 on the total sum of $2,517,465.75 at the rate of 8.36 percent per annum, for a total amount of interest of $236,983.74.

There was no ratification of the ISB loan by the limited partners of 9221 because:

(a) ISB made no claim, and introduced no evidence, that Joseph Gilbert Jr. or The Ann Swift Evans Trust ratified the ISB loan;[71]

(b) Joseph Gilbert, Jr. and The Ann Swift Evans Trust did not ratify the ISB loan;[72]

(c) the only claim of ratification asserted by ISB was to limited partners Alice (Lowenthal) Hechter, Barbara Cleveland, Howard Tierney, Arthur Solomon, the Estate of Arthur Cowan Jr., Joseph Cohen and Aline Cassady, on the basis that Cowan & Co. was the agent for said investors, Cowan &

Co. became aware of the ISB loan in late February, 1986 and participated in the decision in April, 1986 to reclassify it for accounting purposes and treat the loan as an "intercompany" receivable on the books and general ledger of 9221;[73]

(d) after formation of the limited partnership under the Partnership Agreement in 1978, Cowan & Co. only performed administrative tasks in the nature of being a conduit of information: it delivered quarterly reports, K-1 tax forms and other information prepared by KBDC or the partnership accountants; Cowan & Co. did not render tax advice, make decisions for the limited partners or make recommendations to limited partners in lieu of their own decision-making process or physical acts in implementing decisions;

(e) there was no evidence of any substantial continuing relationship after 1978 between Cowan & Co. and Howard Tierney;

(f) there was no evidence of a substantial continuing relationship between Alice (Lowenthal) Hechter and Cowan & Co. after March, 1985; Ms. Hechter relied on her stepson, Albert Lowenthal, for all investment advice related to 9221;[74] Mr. Lowenthal left Cowan & Co. in April, 1985, but received no substantive information from and had an adverse relationship with Cowan & Co. beginning in January, 1985;[75]

(g) Barbara Cleveland had no substantial continuing relationship with Cowan & Co. after 1978; she made her own decisions and

relied on the counseling of her husband, an independent investor;[76]

(h) the only limited partners who had any continuing relationship with Cowan & Co. in 1985 and 1986 were Joseph Cohen, the Estate of Arthur Cowan, Jr., Arthur Solomon and Aline Cassady, who collectively represented only 46.297% of the total limited partnership interests calculated on the basis of units of participation, or 44% of the limited partners based on numbers of partners;[77]

(i) even assuming Cowan & Co. had a sufficient agency relationship to have ratified the ISB loan on behalf of these four limited partners, such ratification was less than the consent of 50% of the limited partners required under the Partnership Agreement;

(j) Cowan & Co. acted as a sales agent for 9221, was paid a commission for its sales activities by 9221,[78] and its actions in performing administrative tasks benefited 9221; and

(k) the limited partners received no benefit from the ISB loan.

There was no sufficient evidence of any set off or any particular amount of set off as a result of any payments of operating expenses of 9221 caused to be paid by KBDC out of the Kroh Brothers Management Co. central depository and disbursement accounts. There was no evidence that any of the ISB loan proceeds were paid to or on account of 9221 for improvements to the 9221 Ward Parkway Building, or any other payments benefiting the

property, and ISB did not provide any consideration to 9221 for the ISB note and Deed of Trust.

ISB is not a good faith transferee entitled to claim set off because ISB was on notice at all times that the ISB loan was an unauthorized transaction that required, but did not have, the consent of the limited partners and was not for a partnership purpose.

II. CONCLUSIONS OF LAW

The actions and fraudulent intent of KBDC, as a general partner of 9221, and the entity that dominated and controlled 9221, may be imputed to 9221. *In re Roco Corp.*, 701 F.2d 978 (1st Cir. 1983); *In re Bell & Beckwith*, 64 B.R. 620 (Bankr. N.D. Ohio 1986).

Neither the ISB loan of April 9, 1985 nor the Commerce Bank loan of October 10, 1986 were authorized by the limited partners at the time of the loans. These loans required consent of at least 50% of the limited partners, yet no written, oral or informal expression of consent was sought or obtained either by ISB or KBDC of any limited partners on either date. *Anchor Centre Partners, Ltd. v. Mercantile Bank*, 783 SW.2d 108 (Mo. App. 1989); *In re Fox Hill Office Investors Ltd.*, 101 B.R. 1007 (Bankr. W.D. Mo. 1989); § 359.090 R.S.Mo. (repealed January 1, 1989).

Neither the ISB loan or Commerce loan was for a partnership purpose, and both loans were obtained by KBDC for its own purposes. *In re Fox Hill Office Investors Ltd., supra; In re West Tech. Ltd.* 104 B.R. 176 (Bankr. W.D. Mo. 1988); *Allen v. Steinberg*, 244 Md. 119, 223 A.2d 240 (App. 1966).

KBDC lacked statutory, common law or contractual authority to execute the ISB note and deed of trust. Since ISB was in possession of the partnership agreement and knew or should have known the partnership agreement contained express limitations on the general partner's authority, both as to the purpose of any loans and the dollar limit of aggregated borrowings, ISB is precluded from arguing that KBDC had either implied or inherent authority. *Anchor Centre Partners Ltd. v. Mercantile Bank, supra; Shelby v. Slepekis,* 687 SW.2d 231 (Mo. App. 1985); *Hamilton Hauling, Inc. v. GAF Corp.,* 719 SW.2d 841 (Mo. App. 1986).

As a result of the ISB loan, general partner KBDC caused a deed of trust lien in the amount of $2,500,000 to be placed on 9221's sole asset, for which transfer 9221 received no consideration or benefit. Similarly, as a result of the Commerce loan and payment of the ISB loan from the Commerce loan proceeds on October 10, 1986, KBDC caused the deed of trust lien on the sole asset of 9221 to be, in effect, transferred to Commerce Bank, for which 9221 received no consideration or benefit. 9221 received none of the proceeds of the Commerce loan and received no benefit from release by ISB of its deed of trust because the lien interest continued to be held by Commerce. *Anchor Centre Partners, Ltd. v. Mercantile Bank, supra.*

As a result of the ISB loan, debtor became insolvent, in that debtor incurred debts beyond its ability to pay as they matured. *Bushman v. Bushman,* 279 S.W. 122 (Mo. 1925).

At the time of the transfer of the Commerce loan proceeds to ISB to pay off the ISB loan on October 10,

1986, debtor's liabilities exceeded its assets, 11 U.S.C. § 101(31); debtor was left with an unreasonably small capital with which to conduct its business; and debtor incurred debts beyond its ability to pay as they matured. *In Re E.D. Preslay Corp.*, 44 B.R. 781 (Bankr. S.D. Fla. 1984); *In re Emerald Hills Country Club*, 32 B.R. 408 (Bankr. S.D. Fla. 1983).

The transfer by KBDC to ISB of the deed of trust lien on the 9221 Ward Parkway Building under the ISB note and deed of trust was a transfer of an interest of debtor in property. Similarly, the proceeds of the Commerce note and deed of trust transferred to ISB in payment of the ISB loan was the transfer of an interest of debtor in property. *Metzger v. Columbia Terminals Co.*, 50 SW.2d 680 (Mo. App. 1932); *McGraw v. Bressler*, 44 B.R. 656 (Bankr. N.D. Ohio 1984). *In re Bullion Reserve of North America*, 836 F.2d 1214 (9th Cir. 1988).

As a condition for closing its loan, Commerce required that the loan could not be closed and funds distributed to ISB until Commerce Bank was assured of ISB's second lien position. Accordingly, since the Commerce loan proceeds paid to ISB were given in exchange for a second deed of trust on the property of 9221 such proceeds were, in fact, debtor's property, which property ISB holds in constructive trust. *Metzger v. Columbia Terminals Co., supra; McGraw v. Bressler, supra; In re Bullion Reserve of North America, supra.*

ISB lacks standing and capacity to attack the validity of the Commerce note and deed of trust or to argue that proceeds of the Commerce loan were KBDC's property and not debtor's property because the Commerce note

and deed of trust were in the name of 9221, the lien on the 9221 Ward Parkway Building remained, and ISB, as a single creditor, may not invoke avoidance powers under the Bankruptcy Code. *Saline State Bank v. Mahloch,* 834 F.2d 690 (8th Cir. 1987); *Nebraska State Bank v. Jones,* 846 F.2d 477 (8th Cir. 1988). Moreover, ISB may not, as a single creditor, assert avoidance powers as a defense to a fraudulent transfer proceeding. *Xonics Photochemical, Inc.,* 841 F.2d 198 (7th Cir. 1988).

Plaintiffs have standing to bring this action. 9221 acts as debtor-in-possession and pursuant to the Plan, is granted all the powers and duties of a trustee under the Bankruptcy Code and succeeds to the rights of a lien creditor, judgment creditor or unsecured creditor, and may avoid transfers made by debtor, which could have been set aside by such creditors. 11 U.S.C. §§ 544(a) and (b). Edward Schmitt, as Agent, is the designated representative for the purpose of prosecuting this action pursuant to the Plan. 11 U.S.C. § 1129(b)(3)(B). 9221 is obligated to pay administrative expense claims to the Segregated Fund; its own operating expenses, including post-petition and post-confirmation trade creditors; and debt service on its secured debt. Accordingly, this action, which was explicitly provided for in 9221's plan and disclosure statement, will inure to 9221 and its unsecured claim holders and will increase the probability of success of 9221's reorganization. *In re Tennessee Wheel and Rubber Co.,* 64 B.R. 721 (Bankr. M.D. Tenn. 1986), *affirmed,* 75 B.R. 1 (M.D.Tenn. 1987).

Such recovery will not allow KBDC to benefit from its own wrongdoing, because KBDC no longer exists as the same entity which prepetition directly participated in

the fraudulent transfers and any distribution that might ultimately be received in the KBDC and related entities' reorganization will be received by the Kroh Operating Limited Partnership and the Segregated Fund for the benefit of KBDC's general unsecured creditors and its related entities. *See Iowa-Missouri Realty Co. v. United States*, 86 B.R. 617 (Bankr. W.D. Mo. 1988).

In *Icwa-Missouri Realty*, this court held that a debtor-in-possession's pre-petition knowledge or notice of facts relating to avoidability of a lien would not prevent the post-petition debtor from avoiding a lien under §§ 544(a)(3) and § 1107(a) as a hypothetical bona fide purchaser. The minority view, *In re Hartman Paving, Inc.*, 745 F.2d 307 (4th Cir. 1984), is contrary to express provisions of § 544(a), *e.g., In re Sandy Ridge Oil Co.*, 807 F.2d 1332, 1336 (7th Cir. 1986), and contravenes Bankruptcy Code policy to allow debtors-in-possession to avoid liens for the benefit of the estate and creditors. *Iowa-Missouri Realty* at 619-20.

Similarly, recovery in this case follows the clear dictates of the Bankruptcy Code to allow retention of avoidance powers by the reorganized debtor, § 1123(b)(3)(B), and the Code's policy of allowing avoidance recoveries to benefit debtor's estate and creditors. *See Kroh Bros. Dev. Co. v. United Missouri Bank of Kansas City*, 100 B.R. 487, 498 (Bankr. W.D. Mo. 1989), *appeal dismissed* 101 B.R. 1000 (W.D.Mo. 1989).

Moreover, ISB is not without remedy. It is entitled to, and has, filed a proof of claim against KBDC's estate to share in distribution along with other creditors.

In April, 1985, plaintiffs were entitled to receive the value of the property transferred, or the value of the second deed of trust lien given to ISB, in the amount of $2,500,000, as such deed of trust was given for no consideration to debtor, without its consent or ratification, and was not for a partnership purpose. 11 U.S.C. § 550(a).

On October 10, 1986, the $2,517,465.75 from the Commerce loan, which was paid to ISB in payment of the ISB Note and Deed of Trust, was an interest in the property of debtor, transferred within one year of the filing of 9221's bankruptcy petition, for which 9221 received no consideration. Plaintiffs' Complaint herein demanded return of the property, which demand has been refused by ISB. Accordingly, plaintiffs are entitled to an order requiring ISB to turn over to plaintiffs the $2,517,465.75. 11 U.S.C §§ 542; *In Re Williams*, 62 B.R. 590 (Bankr. N.D. Tex. 1986).

The actions and fraudulent intent of KBDC, as general partner of 9221, and the entity that dominated and controlled 9221, may be imputed to 9221. *In re Roco Corp.*, 701 F.2d 978 (1st Cir. 1983); *In re Bell & Beckwith*, 64 B.R. 620 (Bankr. N.D. Ohio 1986).

The October, 1986 payment of the ISB loan is avoidable under § 548(a)(1) because it was made with actual intent to hinder, delay and defraud entities to which debtor 9221 was or became indebted as evidenced by the following badges of fraud: debtor's failure to receive consideration for the transfer; debtor's insolvency at the time of the payment; the transfer of the remaining equity of debtor in the real estate – debtor's only asset; and KBDC's efforts to conceal the transaction. *In re Jones*, 68

B.R. 483 (Bankr. W.D. Mo. 1984); *Community Federal Sav. and Loan Assoc. v. Boyer,* 710 SW.2d 332 (Mo. App. 1986).

The payment on October 10, 1986 of the ISB Note and Deed of Trust is avoidable under § 548(a)(2)(b)(i) because debtor received no value for the transfer, as defined in § 548(d)(2)(A), and was insolvent or became insolvent as a result of this transfer. *In the Matter of Keenen,* 19 B.R. 724 (Bankr. W.D. Mo. 1982).

The October 10, 1986 payment to ISB is avoidable under § 548(a)(2)(B)(ii) as a transfer for no value, as defined by § 548(d)(2)(A), in that at the time debtor was engaged in a business for which its remaining property was an unreasonably small capital. Debtor's unreasonably small capital is evidenced by its insolvency, inability to make payments to creditors on a current basis, and need to obtain advances from KBDC to pay debts and expenses. *In re E.D. Preslay Corp., supra; New York Credit Men's Adjustment Bureau, Inc. v. Adler,* 2 B.R. 752 (S.D.N.Y. 1980).

The October 10, 1986 payment to ISB is avoidable under § 548(a)(2)(B)(iii) in that the transfer was made for no value, as defined in 11 U.S.A. § 549(d)(2)(A), and debtor intended and believed it would incur debts beyond its ability to pay as such debts matured. *In re Emerald Hills Country Club, supra.*

The ISB Note and Deed of Trust given pursuant to the April 9, 1985 ISB loan, and the payment of $2,517,465.75 to ISB on October 10, 1986, were fraudulent conveyances of debtor's chattels and land made with the intent to hinder, delay or defraud creditors and may be avoided by plaintiffs pursuant to § 428.020 R.S.Mo.

(1986). *Lindell Trust Co. v. Commonwealth Land Title Insurance Co.*, 611 SW.2d 283 (Mo. App. 1980).

By receipt of the $2,517,465.75 on October 10, 1986, ISB was unjustly enriched through the wrongful actions of a third party, KBDC, in that the ISB loan and its underlying note and deed of trust were unauthorized and debtor received no consideration as a result thereof. Accordingly, ISB must return the sum to debtor. *Newco Land Co. v. Martin*, 213 SW.2d 504 (Mo. 1948).

There was no ratification of the ISB loan by the limited partners of 9221 because:

(a) ISB made no claim, and introduced no evidence, that Joseph Gilbert Jr. or The Ann Swift Evans Trust ratified the ISB loan. Rather, the evidence showed that Joseph Gilbert Jr. and The Ann Swift Evans Trust did not ratify the ISB loan. Accordingly, ISB failed to prove that the loan, which was not for a partnership purpose, was ratified by all the limited partners as required by Missouri law. § 359.090 R.S.Mo. (1986); *Henry v. Cervantes-Diversified & Associates*, 700 SW.2d 89 (Mo. App. 1985);

(b) the only claim of ratification asserted by ISB was to the limited partners Alice (Lowenthal) Hechter, Barbara Cleveland, Howard Tierney, Arthur Solomon, the Estate of Arthur Cowan Jr., Joseph Cohen and Aline Cassady on the basis that Cowan & Co. was the agent for these investors;

(c) after formation of the limited partnership under the Partnership Agreement in 1978,

Cowan & Co. only performed administrative tasks in the nature of being a conduit of information; it delivered quarterly reports, K-1 tax forms and other information prepared by KBDC or the partnership accountants;

(d) there was no evidence of any substantial continuing relationship after 1978 between Cowan & Co. and Howard Tierney;

(e) there was no evidence of a substantial continuing relationship between Alice (Lowenthal) Hechter and Cowan & Co. after March, 1985; Ms. Hechter relied on her stepson, Albert Lowenthal, for all investment advice related to 9221; Mr. Lowenthal left Cowan & Co. in April, 1985 but received no substantive information from and had an adverse relationship with Cowan & Co. beginning in January, 1985;

(f) Barbara Cleveland had no substantial continuing relationship with Cowan & Co. after 1978; she made her own decisions and relied on the counseling of her husband, an independent investor;

(g) the only limited partners who had any continuing relationship with Cowan & Co. in 1985 and 1986 were Joseph Cohen, the Estate of Arthur Cowan, Jr., Arthur Solomon and Aline Cassady, who collectively represented only 46.297% of the total limited partnership interests calculated on the basis of units of participation, or 44% of the limited partners based on number of partners;

(h) even assuming Cowan & Co. had a sufficient agency relationship to have ratified the ISB loan on behalf of these four limited partners, and assuming that § 359.090 R.S.Mo. (1986) is not applicable, such ratification was less than the consent of 50% of the limited partners required under the Partnership Agreement;

(i) even assuming Cowan & Co. had some agency relationship with some limited partners, there was insufficient evidence to show that Cowan & Co. was an agent with the degree of authority that would be required to support a claim of ratification;

(j) even assuming Cowan & Co. had some agency relationship with some limited partners, there was insufficient evidence that either Cowan & Co. or the limited partners had sufficient knowledge of the material facts concerning the ISB loan and the use of the loan proceeds. *Dudley v. Dumont*, 526 SW.2d 839 (Mo. App. 1975);

(k) Cowan & Co. acted as a sales agent for 9221, was paid a commission for its sales activities by 9221, and its actions in performing administrative tasks benefited 9221; and

(l) The limited partners received no benefit from the ISB loan.

Wilks v. Stone, 339 SW.2d 590 (Mo. App. 1960).

There was no sufficient evidence of any set off or any particular amount of set off as a result of any payments of operating expenses of 9221 caused to be paid by KBDC

out of the Kroh Brothers Management Co. central depository and disbursement accounts, including no evidence that any of the proceeds of the ISB loan were paid to or on account of 9221 for improvements to the 9221 Ward Parkway Building, or of any other payments benefiting the property, and ISB did not provide any consideration to 9221 for the ISB Note and Deed of Trust. *Finnell v. Million*, 74 S.W. 419 (Mo. App. 1903); 11 U.S.C. § 548(c); 11 U.S.C. § 550(d).

ISB is not a good faith transferee entitled to claim set off in that ISB was on notice at all times that the ISB loan was an unauthorized transaction that required, but did not have, the consent of the limited partners and was not for a partnership purpose. *Farmer's Bank of Higginsville v. Handly*, 9 SW.2d 880 (Mo. 1928); 11 U.S.C. § 550(d); *Kidder Skis Int'l v. Williams*, 60 B.R. 808 (W.D. Mo. 1985).

III. JUDGMENT

For the foregoing reasons, the court finds that judgment should be entered in favor of plaintiffs and against defendant on Counts I through VI, and Count VIII of Plaintiffs' Second Amended Complaint. Accordingly, it is hereby

ORDRED, ADJUDGED AND DECREED, that judgment be entered in favor of plaintiffs 9221 Associates and Edward E. Schmitt, Agent, in the amount of $2,517,465.75, together with prejudgment interest from February 10, 1989 through March 28, 1990 in the amount of $236,983.74

for a total judgment in favor of plaintiffs and against defendant of $2,754,449.49 plus costs.

/s/ Karen M. See
KAREN M. SEE
U.S. Bankruptcy Judge

1. Stip. 8, 9; Complaint.

2. Stip. 3.

3. Stip. 6.

4. Stip. 7.

5. Stip 1, 2; Trial Exhs. 1, 2; Pltf. Exhs. 3, 4.

6. Stip. 4; Trial Exhs. 2, 4.

7. Trial Exh. 2; Pltf. Exh. 4.

8. Trial Exh. 2; Pltf. Exh. 4.

9. Stip 10; Trial Exhs. 3, 4, 5; Pltf. Exh. 69.

10. Stip. 14.

11. Stip. 11; Trial Exh. 6.

12. Mondschein, Tr. 2-128, 2-132 through 2-133; Trial Exh. 15; Pltf. Exhs. 8, 29.

13. Mondschein, Tr. 2-129, 2-130, 2-139, 2-184; Pltf. Exh. 8.

14. Galvin, Tr. 4-66, 4-67; Pltf. Exhs. 34, 38, 65, 99.

15. Hook, Tr. 1-65, 1-66, 1-68, 1-69; Trial Exh. 6.

16. Hook, Tr. 1-66, 1-67; Cooney, Tr. 1-88, 1-89.

17. Pltf. Exh. 13.

18. Hook, Tr. 1-68, 1-69; Cooney, Tr. 1-84; Galvin, Tr. 4-68, 4-74; Trial Exh. 6, Pltf. Exhs. 13, 14, 26.

19. Hook, Tr. 1-68, 1-69; Cooney, Tr. 1-84; Galvin, Tr. 4-68, 4-74, 4-95; Trial Exh. 6, Pltf. Exhs. 13, 14, 26.

20. Pltf. Exhs. 26, 147; Hook, Tr. 1-73; Cooney, Tr. 1-85, 1-86; Garretson, Tr. 2-235 through 2-237.

21. Solomon, Tr. 1-122, 1-123; Gilbert, Tr. 2-49 through 2-51; Evans, Tr. 2-61 through 2-64; Cleveland, Tr. 2-21 through 2-24; Cassidy, Tr. 2-112 through 2-115; Hechter, Tr. 2-73; Lowenthal, Tr. 2-88, 2-91; Trial Exh. 22; Pltf. Exhs. 36, 50; Deft. Exh. 131.

22. Hook, Tr. 1-72, 1-73; Cooney, Tr. 1-87, 1-88; Garretson, Tr. 2-238, 2-239; Pltf. Exh. 26.

23. Garretson, Tr. 2-238, 2-239; Pltf. Exh. 25.

24. Stip. 17; Trial Exh. 7; Pltf. Exhs. 10, 26.

25. Stip 19.

26. Stip. 13; Pltf. Exh. 26.

27. Cooney, Tr. 1-78, 1-83, 1-84; Tr. 1-98 through 1-100; Pltf. Exhs. 26-28.

28. Stip. 23, 24, 26, 27; Trial Exhs. 11, 12, 13, and 14.

29. Stip. 25.

30. Galvin, Tr. 4-108; Trial Exhs. 2, 3, 4, 5, 11, 12 and 21; Pltf. Exh. 99.

31. Stip 29; Pltf. Exh. 19.

32. Stip. 30; Pltf. Exhs. 19, 20.

33. Stip. 31.

34. Stip. 32.

35. Mondschein, Tr. 2-135, 2-136; Galvin, Tr. 4-60, 4-61; Pltf. Exhs. 34-35.

36. Mondschein, Tr. 2-148; Galvin, Tr. 4-61, 4-62; Pltf. Exhs. 34, 35.

37. Mondschein, Tr. 2-137, 2-138; Galvin, Tr. 4-47 through 4-57; Pltf. Exhs. 34, 35, 36, 99.

38. Galvin, Tr. 4-55 through 4-57; Pltf. Exhs. 34, 35.

39. Mondschein, Tr. 2-174, 2-175; Galvin, Tr. 4-68, 4-74, 4-92, 4-102, 4-103; Pltf. Exhs. 34, 35, 38, 39, 88 through 90, 94, 95, 97, 98, 99.

40. Galvin, Tr. 4-77, 478, 4-102, 4-103; Vanice, Tr. 3-23, 3-39, 3-40, 3-44; Pltf. Exhs. 32, 33, 34, 35, 36, 37, 38, 39, 40, 40A, 40B, 99.

41. Breindel, Tr. 5-196 through 5-200, 5-216, 5-217; Deft. Exh. 131.

42. Kandell, Tr. 4-12.

43. Galvin, Tr. 4-78, 4-79; Pltf. Exhs. 34, 36.

44. Kandell, Tr. 4-22 through 4-25; Galvin, Tr. 4-78, 4-79; Pltf. Exhs. 35, 36, 37.

45. Galvin, Tr. 4-79, 4-80; Pltf. Exhs. 34, 36.

46. Hook, Tr. 1-65, 1-66; Galvin, Tr. 4-60 through 4-62, 4-66, 4-67; Kandell, Tr. 4-41; Mondschein, Tr. 2-132, 2-133, 2-140, 2-141, 2-143, 2-144, 2-147 through 2-149; Trial Exh. 6, 15; Pltf. Exhs. 8, 19, 20, 34, 36, 38, 65.

47. Galvin, Tr. 475.

48. Stip. 36; Trial Exh. 24.

49. Cooney, Tr. 1-89, 1-90.

50. Stip. 37; Trial Exh. 25.

51. Stip. 40, 41; Trial Exhs. 28, 29.

52. Trial Exh. 31; Pltf. Exhs. 47, 48.

53. Stip. 43, 44.

54. Stip. 45; Pltf. Exh. 48.

55. Vanice, tr. 3-39, 3-40, 3-55, 3-57; Galvin, Tr. 4-90, 4-92, 4-94, 4-95, 4-103, 4-106; Kandell, Tr. 4-41; Mondschein, Tr. 2-176, 2-177; Pltf. Exhs. 35, 39, 40, 40A, 40B, 88 through 90, 94, 95, 97, 98, 99.

56. Stip. 46.

57. Solomon, Tr. 1-123; Cleveland, Tr. 2-22, 2-23; Hechter, Tr. 2-73; Gilbert, Tr. 2-48, 2-49; Evans, Tr. 2-61 through 2-64; Cassady, Tr. 2-112 through 2-115; Lowenthal, Tr. 2-89 through 2-91.

58. Galvin, Tr. 4-60 through 4-62, 4-66 through 4-68, 4-74, 4-77, 4-78, 4-79, 4-90, 4-92, 4-94, 4-95, 4-102, 4-103, 4-106; Mondschein, Tr. 2-174 through 2-177; Kandell, Tr. 4-22 through 4-25, 4-41; Trial Exhs. 6, 25; Pltf. Exhs. 8, 20, 25, 26, 34, 35, 36, 37, 38, 39, 40, 40A, 40B, 88 through 90, 94, 95, 97, 98, 99.

59. Solomon, Tr. 1-122, 1-123; Cleveland, Tr. 2-22, 2-24; Evans, Tr. 2-63, 2-64; Gilbert, Tr. 2-49 through 2-51; Hechter, Tr. 2-73; Cassady, Tr. 2-112; Lowenthal, Tr. 2-88; Kandell, Tr. 4-36, 4-37; Galvin, Tr. 4-107-8; Trial Exhs. 2 and 29; Pltf. Exhs. 20, 34, 36.

60. Mondschein, Tr. 2-176, 2-177; Galvin, Tr. 4-90, 4-92, 4-94, 4-95, 4-103, 4-106; Kandell, Tr. 4-41; Vanico, Tr. 3-39, 3-40, 3-55, 3-57; Trial Exhs. 3, 4, 5, 11, 12, 28, 29; Pltf. Exhs. 25, 32, 33, 34, 35, 37, 38, 39, 40, 40A, 40B, 88, 89, 90, 94, 95, 97, 98, 99.

61. Mondschein, Tr. 2-176, 2-177; Galvin, Tr. 4-92, 4-103; Kandell, Tr. 4-41; Vanice, Tr. 3-57; Trial Exh. 6; Pltf. Exhs. 25, 32, 33, 35, 37, 39, 40, 40A, 40B, 88, 89, 90, 94, 95, 97, 98, 99.

62. Mondschein, Tr. 2-174 through 2-177; Galvin, Tr. 4-95; Kandell, Tr. 4-41; Vanice, Tr. 3-23, 3-39, 3-40, 3-55 through 3-57; Trial Exh. 2; Pltf. Exhs. 25, 32, 33, 34, 35, 37, 38, 39, 40, 40A, 40B, 88, 89, 90, 94, 95, 97, 98, 99.

63. Pltf. Exhs. 72 through 87.

64. Trial Exh. 2.

65. Trial Exh. 6.

66. Mondschein, Tr. 2-128, 2-132 through 2-133; Findings of Fact 10, 36, 37.

67. Findings of Fact 50, 51.

68. Findings of Fact 19, 20; Trial Exh. 2.

69. Trial Exh. 6.

70. Complaint and Answer.

71. Tr. 2-42, 2-50.

72. Gilbert, Tr. 2-42, 2-50, 2-51; Evans, 2-64, 2-66.

73. Tr. 1-39 through 1-44.

74. Hechter, Tr. 2-69, 2-70.

75. Lowenthal, Tr. 2-85, 2-86, 2-101, 2-102.

76. Cleveland, Tr. 2-13, 2-14, 2-16 through 2-18, 2-20, 2-21.

77. Trial Exh. 4.

78. Breindel, Tr. 5-213, 5-214.

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 91-3571WMKC

9221 Associates, a Missouri Limited Partnership; Ed Schmitt, Plaintiffs-Appellants, vs. Industrial State Bank, Defendant-Appellee.	* * * * * * * * * *	Order Denying Petition for Rehearing and Suggestion for Rehearing En Banc

The suggestion for rehearing en banc is denied. The petition for rehearing is also denied.

October 5, 1992

Order Entered at the Direction of the Court:

/s/ Michael E. Gans

Clerk, U.S. Court of Appeals, Eighth Circuit

No. 92-1162

Supreme Court, U.S.
FEB 1 1993
OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1992

9221 ASSOCIATES and EDWARD E. SCHMITT, AGENT,

Petitioners,

v.

INDUSTRIAL STATE BANK,

Respondent.

On Petition For A Writ of Certiorari To The United States Court of Appeals For The Eighth Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Filed: January 30, 1993

QUESTION PRESENTED FOR REVIEW IF PETITION FOR WRIT OF CERTIORARI WERE GRANTED

Were this Court to grant petitioners' Petition For Writ Of Certiorari only one question would be presented for review: Under Missouri agency law, does an unauthorized, unratified borrowing by an agent create a lien on his principal's real estate and loan proceeds that are his principal's property?

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STATEMENT OF THE CASE

In this action, Kroh Brothers Development Company ("KBDC"), the general partner of petitioner 9221 Associates ("9221"), borrowed money from two banks and purported to place mortgage liens on 9221's real estate. KBDC had neither actual nor apparent authority to do so, and 9221 did not ratify KBDC's borrowings or actions.

KBDC first borrowed $2.5 million from respondent Industrial State Bank ("ISB") and purported to give ISB a second deed of trust on 9221's real estate.[1] Seventeen months later, KBDC borrowed $4 million from Commerce Bank of Kansas City, purported to give Commerce Bank a second deed of trust on 9221's real estate, and repaid the ISB loan from the proceeds of the Commerce Bank loan. While taking money from both ISB and Commerce Bank, KBDC took no money from 9221.

Five months after ISB's loan was repaid, 9221 filed for relief under Chapter 11 of the Bankruptcy Code. 9221 filed this action two years later. Contending that KBDC had placed enforceable liens on its real estate and that therefore the Commerce Bank loan proceeds were its property, 9221 sought a judgment against ISB in the amount of $2.5 million -- the amount of Commerce Bank loan proceeds that KBDC used to repay the ISB loan.

The District Court reversed the Bankruptcy Court's judgment for 9221 [A.5-12], holding that under applicable Missouri law 9221's real estate "was unaffected in any manner" by KBDC's unauthorized, unratified acts and that 9221 "can assert no

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[1] ISB's parent company is Industrial Bancshares, Inc.; ISB has no nonwholly owned subsidiaries.

property interest in the proceeds of the Commerce loan" [A.11]. The Court of Appeals for the Eighth Circuit ("Eighth Circuit") affirmed the District Court for the reasons stated by the District Court. [A.1-4.] Without dissent, the Eighth Circuit denied petitioners' suggestion for rehearing en banc and petition for rehearing.

SUMMARY OF ARGUMENT

This case was correctly decided based on elementary principles of state law and raises only issues of state law. None of the "Questions Presented" set out in the Petition For Writ Of Certiorari ("Petition") are presented by this case. The petitioners' arguments in support of their position misstate both the law and the decision of the Eighth Circuit in this case.

ARGUMENT

REASONS FOR DENYING THE WRIT

9221 attempted in this case to convert the unauthorized, unratified acts of its general partner into a $2.5 million windfall. Applying elementary state-law rules of agency, the District Court and Eighth Circuit did not permit 9221 to do so. There is no conceivable reason for this Court to review the Eighth Circuit's decision.

This case does not present any of the "Questions Presented" set out at pages i and ii of the Petition. Questions 1-3 are based on the incorrect premise that the Eighth Circuit held that KBDC placed an "unauthorized lien" on 9221's real estate. That is not true. Applying elementary principles of agency law, the Eighth Circuit held that, under applicable Missouri law, KBDC's unauthorized, unratified acts placed *no* valid or enforceable lien on 9221's real estate. Question 4 incorrectly states that the Eighth Circuit held that a defendant in a bankruptcy avoidance action can defend on the ground that another transaction is avoidable. That also is not true. The Eighth Circuit did not touch the issue, and the District Court simply pointed out that "[c]ertainly ISB has standing to assert that 9221 had no property interest in the loan proceeds sought to be divested from ISB." [A.9 n.2.]

A. The Decision Below Creates No Conflict

Except for a standing issue, *see* D below, petitioners do not even argue that the Eighth Circuit's decision conflicts with a decision of another United States court of appeals or has decided a federal question in a way in conflict with a state court of last resort. *See* Supreme Court Rule 10.1(a). Rather, they argue that the Eighth Circuit's decision conflicts with two prior decisions of the Eighth Circuit: *In re Fox Hill Office Investors, Ltd.*, 926 F.2d 752 (8th Cir. 1991), and *In re West Tech, Ltd.*, 882 F.2d 323 (8th Cir. 1989). There is no conflict.

In *Fox Hill* (decided under Kansas law), in *West Tech* (decided under Florida law) and in this case (decided under Missouri law), the Eighth Circuit applied basic state law principles and reached the same result. Applying elementary rules of agency

law in all three cases, the Eighth Circuit held that the real estate of the partnership before the court could not be encumbered by the purported liens that their general partners attempted, without authority, to place on the real estate.[2]

B. The Decision Below Neither Limits Nor Misinterprets 11 U.S.C. §§101(54), 544 or 548

Petitioners incorrectly state that the Eighth Circuit's decision limits avoidable transfers under the Bankruptcy Code to "authorized" transfers. That is not true. The Eighth Circuit's decision is based on the fact that, under applicable Missouri law, the purported lien that KBDC attempted to place on 9221's real estate was invalid and resulted in *no* transfer. 9221's real estate "was unaffected in any manner." [A.4.]

C. The Decision Below In No Way Casts Doubt On Record Titles

Petitioners' hypothetical incorrectly assumes that a borrower can "obtain[] a mortgage" from an agent acting without authority. *See* Petition at 16. A borrower cannot do so.

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[2] "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Butner v. United States*, 440 U.S. 48, 55 (1979).

There is nothing in the record (nor could there be) that supports the statement at Petition 12 that "9221 Associates relied, in part, on the prior holdings of the Eighth Circuit in formulating its reorganization."

Petitioners' contention that under the Eighth Circuit's decision a chapter 11 debtor has "no remedy" in the event an invalid lien is recorded against his property, *see* Petition at 17, is wrong. He can do what any party would do: file an action to quiet title.[3]

D. The Decision Below Creates No Intercircuit Conflict

There is no conflict between the Eighth Circuit decision and the Seventh Circuit decision in *In the Matter of Xonics Photochemical, Inc.*, 841 F.2d 198 (7th Cir. 1988). ISB did not seek to exercise avoidance powers in this case. It simply defended on the ground that KBDC's unauthorized, unratified acts did not result in a valid lien on 9221's real estate or the transfer of any 9221 property. *See* decision of district court below at A-9 n.2.

[3] "The trustee in a case under this title has capacity to sue. . . ." 11 U.S.C. §323. "[T]he trustee or debtor in possession may . . . commence and prosecute any action or proceeding in behalf of the estate before any tribunal." Rule of Bankruptcy Procedure 6009.

CONCLUSION

For the reasons stated above, we respectfully request the Court to deny the Petition.

Dated: January 30, 1993

Respectfully submitted,

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